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**In the Supreme Court of the United States**

OCTOBER TERM, 1960

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SMALL BUSINESS ADMINISTRATION, PETITIONER

v.

G. M. McCLELLAN, TRUSTEE

---

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF  
APPEALS FOR THE TENTH CIRCUIT

---

**BRIEF FOR THE SMALL BUSINESS ADMINISTRATION**

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## OPINIONS BELOW

The opinion of the United States District Court for the District of Kansas (R. 38-43) is reported at 168 F. Supp. 483. The opinion of the United States Court of Appeals for the Tenth Circuit (R. 45-49) is reported at 272 F. 2d 143.

## JURISDICTION

The judgment of the court of appeals was entered on November 6, 1959 (R. 50). On January 25, 1960, Mr. Justice Whittaker entered an order extending the time to file a petition for a writ of certiorari to and including February 24, 1960 (R. 50). The petition for certiorari was filed on February 24, 1960, and

granted on April 18, 1960 (R. 51), 362 U.S. 947. The jurisdiction of this Court rests upon 28 U.S.C. 1254(1).

#### QUESTIONS PRESENTED

1. Whether, where an agency of the United States participates with a private financial institution in making a loan, the agency must be denied the debt priority granted the United States by R.S. § 3466, 31 U.S.C. 191, solely because, by virtue of the participation agreement between the two, the private institution will share ratably in any amounts recovered on the loan by the Government agency.

2. Whether, by purchasing a 75% "participation" in a loan made by a bank to a borrower, the Small Business Administration became the owner of a 75% interest in the debt, so that there was then a debt due to the Administration from the borrower.

3. Whether debts due to the Small Business Administration are "debts due to the United States" within the meaning of R.S. § 3466.

4. Whether the Small Business Act excepted loans made under it from the priority granted by R.S. § 3466.

#### STATUTES INVOLVED

1. Section 64 of the Bankruptcy Act, as amended, 11 U.S.C. 104, provides in pertinent part:

§ 104. *Debts which have priority.*

(a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be \* \* \* (5) debts owing to any person, including the United

States, who by the laws of the United States i[s] entitled to priority \* \* \*.

2. Section 3466 of the Revised Statutes, 31 U.S.C. 191, provides:

§ 191. *Priority established.*

Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

**STATEMENT**

This suit was brought by the Small Business Administration, a non-incorporated agency of the United States, to review the order of a referee in bankruptcy denying the S.B.A.'s claim to priority on a debt owing from the bankrupt.

1. On October 8, 1956, S. H. Byquist submitted an application for a \$20,000 loan to the Brookville State Bank (hereafter "Bank") of Brookville, Kansas (R. 15-24). The application was made on an S.B.A. form headed "Limited Loan Participation Application for Loan" (R. 15), and contained two credit reports labeled "For Use of Small Business Administration only" (R. 19-22). In the applica-

tion the borrower agreed that "In consideration of the making by SBA to applicant of all or any part of the loan applied for in this application, applicant hereby agrees with SBA that applicant will not, for a period of two years after disbursement by SBA to applicant of said loan," employ any person who worked for S.B.A. on the date of disbursement or within one year prior to that date (R. 22). The application also stated that "All information contained [in the application is] submitted for the purpose of inducing SBA to grant a loan, or to participate in a loan by a bank or other lending institution, to applicant" (R. 23). On October 30, 1956, the Bank endorsed Byquist's application, indicating that it would make the loan requested, but 'only on condition that the S.B.A. participate in the loan immediately to the extent of 75 percent, that is, \$15,000 (R. 24).

On November 2, 1956, the Administrator authorized the S.B.A. to enter into a "Participation Agreement" with the Bank for the purchase from the Bank of an immediate 75 percent participation in the loan to be made to Byquist (R. 24-26). The same day, Byquist was advised that the S.B.A. had approved his application for an immediate participation loan (R. 29). The Participation Agreement was signed by the Bank and sent to the S.B.A. on November 16, 1956, and was signed and dated by the S.B.A. on November 19, 1956 (R. 27-28). The Agreement provided, *inter alia*, that the S.B.A. would, upon written demand by the Bank, purchase from the Bank a 75 percent participation of each disbursement made to

the borrower (R. 4); that the Bank would hold the note, but that it would transfer the note to S.B.A. within five days if S.B.A. should make a written demand therefor (R. 8); and that neither party to the agreement could, without the prior consent of the other, make or consent to any alteration in the terms of the note or sue upon the note (R. 8).

In addition, the Agreement contained the following provisions (R. 8-9):

12. ADMINISTRATION OF LOAN.—The holder of the Note shall receive all payments on account of principal of, or interest on, the Loan and promptly remit to the other party its pro rata share thereof determined according to their respective interests in the Loan \* \* \*.

\* \* \* \* \*

14. LIABILITY AND REPRESENTATIONS.—\* \* \* neither party shall be liable to the other for any loss, not due to its own gross negligence, but such loss, shall be borne ratably by S.B.A. and Bank in accordance with their respective interests in the Loan.

In compliance with the agreement and upon demand of the Bank, the S.B.A. sent a check for \$15,000, dated November 23, 1956, and drawn on the Treasurer of the United States, to the Bank for the sole purpose of purchasing a 75 percent interest in the loan to Byquist (R. 15, 28). The Bank's right to accept and negotiate the check was expressly conditioned on the Bank's execution and delivery to S.B.A. of a Participation Certificate (S.B.A. Form 152) as evidence of the purchase by S.B.A. of its interest in the loan (R. 28).

The Bank then disbursed the loan of \$20,000 to Byquist (R. 31, 39) and executed and delivered to the S.B.A. the required Participation Certificate.<sup>1</sup>

The loan was evidenced by a note, dated November 16, 1956, to the order of the Bank (R. 9-13). The note was on another S.B.A. form and was headed "NOTE (For Limited Loan Participation Only)" (R. 9). In the note, the borrower covenanted, *inter alia*, to use the proceeds of the loan solely for the purposes set forth in the S.B.A.'s loan authorization, and to reimburse "Holder and S.B.A., respectively," for expenses incurred by them in connection with this loan (R. 11).

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<sup>1</sup> The executed Participation Certificate (S.B.A. Form 152) is not in the record, but its execution by the Bank is not questioned. For the sake of completeness, the text of the certificate is printed below:

#### PARTICIPATION CERTIFICATE

BROOKVILLE STATE BANK (hereinafter called "Bank"), hereby certifies that Small Business Administration (hereinafter called "SBA") has purchased from Bank a participation of 75% of \$20,000.00, representing the amount of the disbursement, or the aggregate amount of the disbursements (as the case may be) made by Bank on the 23rd day of November 1956, and remaining unpaid on the date of such purchase, on account of a loan by Bank to S. H. Byquist, d/b/a Western Distributors, Salina, Kansas, in an amount not exceeding \$20,000.00, such purchase having been made pursuant to a Participation Agreement dated November 19, 1956, between SBA and Bank.

Dated: November 23, 1956

By [S] BROOKVILLE STATE BANK (Bank)  
 R. D. POWERS  
 Cashier (Title)  
 Brookville, Kansas (Address)

2. An involuntary petition in bankruptcy was filed with respect to Byquist on August 17, 1957, and he was adjudged a bankrupt on September 5, 1957 (R. 38). On October 22, 1957, a trustee was appointed (R. 38). He proceeded with the liquidation of the estate and holds a sum somewhat in excess of \$19,000 (R. 32, 38). Claims totaling \$43,682.07 have been filed, and the cost of administration has been estimated at \$6,500.00 by the trustee (R. 32).

After the filing of the petition in bankruptcy, the Bank transferred Byquist's note to the S.B.A. (R. 32). The S.B.A., on behalf of the United States, filed a priority claim in the bankruptcy proceedings under Section 64 of the Bankruptcy Act, 11 U.S.C. 104, *supra*, p. 2, which provides that "debts owing to any person, including the United States, who by the laws of the United States, i[s] entitled to priority" are accorded a fifth priority in bankruptcy. The S.B.A. claimed such priority "by the laws of the United States" over the other unsecured creditors by virtue of R.S. § 3466, 31 U.S.C. 191, *supra*, p. 3, which provides that "debts due to the United States shall be first satisfied" out of the estate of an insolvent debtor. The S.B.A. filed a claim for the sum of \$16,355.69<sup>2</sup> representing the entire amount still unpaid on the note, with interest through October 15, 1957 (R. 2-3). Recognizing, however, that 25 percent of that claim represents an amount owed by the bankrupt to the Bank, the Government has, through-

<sup>2</sup> As originally filed, the claim was for \$16,788.42, but it was later stipulated that the correct figure, after all credits, was \$16,355.69 (R. 34).

out these proceedings, in fact claimed priority only for \$12,266.77, its 75 percent interest in the debt (R. 34).<sup>3</sup>

On objections by the trustee (respondent here) to the claimed priority, the referee in bankruptcy denied priority to the S.B.A.'s claim on the ground that the S.B.A. is an independent agency not entitled to the debt priority accorded to the United States by R.S. §.3466 (R. 33-36). The claim was thus allowed only as a non-priority, unsecured claim (R. 35-36).

3. After denial of its claim for priority, the S.B.A. filed a petition for review in the United States District Court for the District of Kansas. The district court rejected the referee's conclusion that the S.B.A. could not claim the debt priority accorded to the United States, but, nevertheless, affirmed the referee's order on the ground that there was no debt running from the bankrupt to the S.B.A. until assignment of the note to the S.B.A., subsequent to the date of bankruptcy (R. 38-43). In support of its decision, the court pointed out, *inter alia*, that the note executed

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<sup>3</sup> The \$12,266.77 sought by the S.B.A., and for which priority is here asserted, represents the extent to which the S.B.A.'s \$15,000 participation in the loan remains unpaid. Since the Bank's 25 percent interest in the debt was assigned to the S.B.A. subsequent to the date of bankruptcy, that portion of the debt remained, for bankruptcy purposes, a claim of the Bank. While the court of appeals' opinion does not indicate that the Government's priority claim was for only \$12,266.77, the amount due it, and not for the \$16,355.69 owing on the entire loan, this fact was made clear by the Government throughout the proceedings. The court of appeals failed to make this plain in its opinion presumably because, in view of its reasoning, the amount for which the S.B.A. was claiming priority was irrelevant.

by the bankrupt was made payable to the Bank only, that the S.B.A. paid its \$15,000 share of the loan to the Bank, and that the Bank paid the full amount of the loan to the bankrupt (R. 42). Accordingly, the court held that, since under *United States v. Marxen*, 307 U.S. 200, the status of a claim against a bankrupt's estate is determined on the date the petition is filed, and since an assignment after that date cannot give an assignee any greater rights than those of his assignor, the S.B.A.'s claim to priority must be denied (R. 42-43).

On appeal by the S.B.A., the Court of Appeals for the Tenth Circuit affirmed, but on still another ground (R. 45-49). The court assumed, *arguendo*, both that the Small Business Administration is entitled to the statutory priority granted the United States (R. 47), and that, by virtue of its immediate participation in the loan, the Small Business Administration became beneficial owner of a 75 percent interest in the debt prior to the filing of the petition in bankruptcy (R. 47-48). The court held, however, that the S.B.A. could not assert a priority for the amount owing to it because, in its participation agreement with the bank, it had agreed to share ratably the proceeds and losses resulting from the transaction with the borrower. The court stated (R. 49):

In *Nathanson v. National Labor Relations Board*, 344 U.S. 25, 28, it was said that § 3466 may not be extended to create a priority for a claim which the United States is collecting for a private party. This principle would be violated if the claim of the United States were here given priority.

The United States is bound by its written contract to account to the Bank for the Bank's 25% share of any collection made under the note. Hence, the Bank would share to that extent in any proceeds resulting from the award of a priority to the United States. \* \* \*

\* \* \* [The United States] may not assert a priority which will produce a recovery that by contract must be divided with a private entity.

#### SUMMARY OF ARGUMENT

The basic question in this case is whether the claim of the United States which was filed by the S.B.A. in the bankruptcy proceeding is entitled to priority over the claims of other unsecured creditors. Under Section 64 of the Bankruptcy Act, 11 U.S.C. 104, *supra*, "debts owing to any person, including the United States, who by laws of the United States, i[s] entitled to priority" are accorded a fifth priority. If the S.B.A. were given that priority here, its claim would take precedence over the claims of the other unsecured creditors. It is our contention that the S.B.A. is entitled to such priority under R.S. § 3466, which provides that "debts due to the United States shall be first satisfied" out of the estate of an insolvent debtor.

#### I

The court below erred in holding that the S.B.A. cannot claim a debt priority here with respect to the amount owed to it by the bankrupt because, by contract, it is bound to remit to the participating bank the latter's pro rata share of all amounts collected

on the debt. While it is settled that the United States may not invoke its priority right so as to collect a debt owing to a private party, this principle is inapplicable in the present case because the S.B.A. is asserting priority for a claim owned by it alone.

What the S.B.A. has contracted to do with its priority recovery is not properly relevant to the question of whether it is entitled to a priority. The S.B.A.'s outside contractual arrangements cannot affect the bankruptcy rights of the other creditors and do not interfere with the scheme of distribution of the Bankruptcy Act.

In addition, important policy considerations pertaining specifically to the objectives of the Small Business Act strongly favor allowance of the priority sought here by the S.B.A.

## II

The claim for which the S.B.A. asserts priority constituted a debt due the United States on the date of the filing of the petition in bankruptcy. While the note evidencing the debt was payable to the order of the participating bank and was formally assigned to the S.B.A. only after the bankruptcy, the S.B.A. was beneficial owner of a 75% interest in the debt from the time that it purchased a 75% "participation" in the loan, long before the date of bankruptcy.

In response to the Bank's written demand, the S.B.A. sent the Bank a Treasury check for the sole purpose of purchasing an undivided 75% share in the loan to the bankrupt. The Bank accepted the

S.B.A.'s check; disbursed the loan, and sent the S.B.A. a Participation Certificate certifying that the S.B.A. had purchased a portion of the loan. Nothing more was needed to make the S.B.A. the owner of 75% of the debt from the bankrupt. The promissory note tendered by the bankrupt could have been demanded at any time by S.B.A. The note, in any event, constituted merely the evidence of the debt since its transfer to one or the other of the participating parties could not alter their respective interests in the actual debt.

### III

Debts due the S.B.A. are clearly "debts due to the United States" within the meaning of R.S. § 3466. The S.B.A. is an unincorporated agency of the United States Government which, in carrying on its statutory operations, administers and lends funds originating from Congressional appropriations. It is settled that such an agency must be regarded as the United States for the purposes of R.S. § 3466.

### IV

There is no language in the Small Business Act which expressly denies the S.B.A. the priority granted by R.S. § 3466, nor is the S.B.A.'s assertion of the priority right basically inconsistent with the objectives sought to be achieved by the Small Business Act. Indeed, the legislative history of the 1958 amendments

to the Small Business Act of 1953 shows full Congressional acceptance of the view that the S.B.A. is entitled to the benefits of R.S. § 3466.

#### ARGUMENT

The preference, in the public good, of debts due the United States over private debts is a policy dating back to the beginning of the nation<sup>\*</sup> and one to which this Court, repeatedly reminding the lower courts that R.S. § 3466 must be liberally construed,<sup>5</sup> has given full effect. The several decisions below, each seizing upon a different technical ground to defeat the S.B.A.'s priority, are, we believe, inconsistent with that policy and unsupportable even on a strict construction of R.S. § 3466.

Dealing first with the ground of the court of appeals' decision, we will show that the S.B.A.'s con-

<sup>\*</sup>The statute is derived from early statutes enacted for the collection of taxes, and its provisions have been in force since 1797 without significant modification. See *Price v. United States*, 269 U.S. 492, 500-501; *United States v. Emory*, 314 U.S. 423, 428.

In bankruptcy proceedings, of course, while R.S. § 3466 is the source of the priority, it is § 64 of the Bankruptcy Act that governs its relative rank. Under that section, claims given priority by R.S. § 3466 are in the fifth priority rank. See *Guarantee Title & Trust Co. v. Title Guaranty & Surety Co.*, 224 U.S. 152; 3 Collier, *Bankruptcy*, ¶ 64.502 (14th ed. 1956).

<sup>5</sup>See e.g., *United States v. State Bank of North Carolina*, 6 Pet. 29, 35; *Price v. United States*, 269 U.S. 492, 500; *United States v. Emory*, 314 U.S. 423, 428; *Bramwell v. U.S. Fidelity Co.*, 269 U.S. 483, 487; *Beaston v. Farmers' Bank*, 12 Pet. 102, 134.

tractual undertaking to share proceeds and losses with the Bank is irrelevant to, and cannot affect, the priority to which the debt due the S.B.A. is otherwise entitled (Point I). We will then show that, contrary to the decision of the district court, the debt to the S.B.A. arose prior to bankruptcy (Point II) and that, contrary to the referee's decision, debts due the S.B.A. are "debts due to the United States" within the meaning of R.S. § 3466 (Point III). We will deal finally with the one remaining contention of respondent that has not been adopted by any of the tribunals below and show that the Small Business Act neither expressly nor impliedly excepts loans made under it from the priority granted by R.S. § 3466 (Point IV).

## I

THE PRIORITY OF THE DEBT DUE THE S.B.A. IS NOT AFFECTED BY THE AGREEMENT BETWEEN THE S.B.A. AND THE PARTICIPATING BANK TO SHARE THE PROCEEDS AND LOSSES ON THEIR RESPECTIVE INTERESTS IN THE LOAN

The court of appeals held that, even if the S.B.A. were otherwise entitled to priority on its \$12,000 share of the total outstanding loan of \$16,000,\* it lost that right to priority when it entered into a contract with the Bank to share pro rata the proceeds and losses on their respective interests in the loan. The court reasoned that no priority could be allowed because the

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\*The figures are rounded off for simplicity. The amount actually remaining unpaid was \$16,355.69, of which the S.B.A.'s 75% share was \$12,266.77 (R. 34).

Bank, by virtue of the contract, would share in its proceeds and, under *Nathanson v. NLRB*, 344 U.S. 25, the priority statute "may not be extended to create a priority for a claim which the United States is collecting for a private party" (R. 49).

We will show that priority has not in fact been asserted for any claim due a private party and that the nature of the claim for which priority is asserted—a debt beneficially owned by the United States—is not affected by the agreement between the S.B.A. and the Bank to pool the proceeds and losses on their respective claims; that the policies of the Small Business Act require that priority be given the S.B.A.'s share of participation loans; and, finally, that even if allowing the Bank to share in the proceeds of the S.B.A.'s priority would be inconsistent with the purposes of R.S. § 3466, total disallowance of the S.B.A.'s priority would not be the appropriate remedy.

A. THE SOLE CLAIM FOR WHICH PRIORITY IS ASSERTED IS A DEBT BENEFICIALLY OWNED BY THE S.B.A., THE NATURE OF WHICH IS NOT AFFECTED BY THE PARTICIPATION AGREEMENT

1. The nature of the claim for which priority is asserted here is totally different from that involved in *Nathanson*, and the principle of that case is inapplicable. In that case, the National Labor Relations Board, to remedy an unfair labor practice committed by an employer, had ordered the employer to reinstate certain employees with back pay. When the employer went into bankruptcy, the Board filed a claim for the back pay due the employees. Although

upholding the Board's right, because of its exclusive power to enforce its own orders, to enforce the claim for back pay, this Court held that the claim was not entitled to priority under R.S. § 3466, stating (344 U.S. at 27-28):

We do not, however, agree with the lower court that this claim, enforceable by the Board, is a debt due the United States within the meaning of R.S. § 3466 \* \* \*. The priority granted by that statute was designed "to secure an adequate revenue to sustain the public burthens and discharge the public debts." \* \* \* There is no function here of assuring the public revenue. The beneficiaries of the claims are private persons \* \* \*.

\* \* \*

It is true that \* \* \* [because of the status of Indians as wards of the United States, priority has been given to claims by the United States for Indian moneys]. We cannot extend that reasoning so as to give priority to a claim which the United States is collecting for the benefit of a private party.

The basis for the decision, in short, was that the United States had no beneficial interest in the claim and was acting solely as an enforcement agency to collect debts beneficially owing entirely to private parties.

The complete answer to the court's reliance on *Nathanson* is that here the only claim "which the United States is collecting for the benefit of a private party" is the \$4,000 share of the loan that is beneficially owned by the Bank, and for that claim no priority has in fact been asserted. Giving full effect

to *Nathanson*, the S.B.A. limited its claim of priority to the \$12,000 actually advanced by and not yet repaid to it, and that part of the debt admittedly is beneficially owing to the United States. The difference between *Nathanson* and this case, in short, is that in *Nathanson* the United States was not the beneficial owner of the debt for which priority was claimed while in this case it is.

2. It is true that if the S.B.A. recovers the \$12,000 owing to it and the Bank fails to recover the \$4,000 owing to it, the S.B.A. will be required, by virtue of its contract with the Bank, to share its proceeds with the Bank and thus absorb a part of the Bank's loss. If so, however, the S.B.A.'s contribution to the Bank will be at its own expense and not at the expense of other creditors, for to the same extent that the S.B.A. pays over a part of its proceeds to the Bank its own claim against the bankrupt will remain unsatisfied. The crucial fact is that there is a debt beneficially owing to the United States in the full amount of the claimed priority, and the way in which the S.B.A. and the Bank have agreed to account to each other for the proceeds of their respective claims against the bankrupt is a matter of concern only to the S.B.A. and the Bank.

The court of appeals suggests that to allow the priority here would be "to prefer the Bank over the other private creditors" (R. 49), but patently that is not so. The other creditors are in no way prejudiced or even affected by the contract between the S.B.A. and the Bank. The S.B.A. itself advanced, and is admittedly entitled to recover on its own behalf, the

full \$12,000 for which priority is asserted. But for the coincidental agreement with the Bank, the \$12,000 would admittedly be a prior claim against the estate, and the agreement has in no way increased or affected the amount of the claimed priority. The other creditors will receive precisely the same distribution they would have received had there been no such agreement. So also the Bank, on its \$4,000 interest in the debt, will receive as a distribution from the estate precisely the same proportion of its claim as the other private creditors. Anything else the Bank realizes on its loan transaction it will receive, not as a claimant in the bankruptcy proceedings, but solely by virtue of its independent agreement with the United States and out of the United States' own recovery. The agreement, in short, may give the Bank an advantage over the United States that it would not otherwise have, but it gives it no advantage over, or at the expense of, the other creditors.

In terms of any "preference" given one common creditor over another, the case here is, in fact, no different from one in which one creditor of a bankrupt agrees with another—in order, for example, to induce the second to extend credit—that any recovery on the two claims will go first to the second creditor until his claim had been paid in full. Clearly that independent agreement between the two creditors would afford no basis for disallowing the first creditor's claim on the ground that to allow it would be to prefer the second. So long as the second creditor's advantage is solely at the expense of the first creditor and the agreement between them does not prejudice

the other creditors, their private arrangements for sharing the proceeds of their claims is of no concern to the bankruptcy court.

3. We may note, finally, that even if the contractual arrangements between the S.B.A. and the Bank were to be taken into account in determining the priority to be allowed, the result would not necessarily be, as respondent assumes, to reduce the allowable priority to zero. Starting with a debt due the S.B.A., and presumptively entitled to priority, of \$12,000, respondent argues that, since \$3,000 of that would have to be paid over to the Bank, only the \$9,000 that would remain with the S.B.A. should be entitled to priority. As respondent points out, however, that would not solve the problem, for 25% of a \$9,000 distribution would in turn have to be paid over to the Bank, leaving the S.B.A. with only \$6,750, and so on ad infinitum, from which respondent concludes that the only solution is to disallow the S.B.A.'s priority in toto (Br. in Opp. 10-11).

It can be said with equal plausibility, however, that the progression works the other way, for with each payment over to the Bank there remains a "debt due to the United States" which has not yet been satisfied and which, presumably, is therefore entitled to priority. There is initially a debt due the United States of \$12,000, which R.S. § 3466 requires "shall be first satisfied" before other debts are paid. If the participation agreement is taken into account, however, it is clear that a distribution of only \$12,000 would, after payment of 25% to the Bank, still leave an "unsatisfied" debt due the United States of \$3,000.

If debts due the United States are to be "first satisfied", a further distribution of \$3,000 would be required, which in turn would still leave unsatisfied a debt of \$750, and so on ad infinitum. The solution to that problem, of course, would be to give the S.B.A. a priority for the full \$16,000 loan to begin with, so that its \$12,000 debt will be fully "satisfied" before payment of other creditors.

The point is that, if, as respondent insists, the participation agreement must be taken into account, it can lead as readily to a conclusion that a \$16,000 priority should be allowed as to a conclusion that no priority should be allowed. There is no more reason, *a priori*, to deny the S.B.A.'s priority altogether to make sure the Bank gets nothing than there is to give a \$16,000 priority to make sure that the S.B.A. gets its full \$12,000. The proper answer we think is that what the S.B.A. and the Bank have agreed between themselves to do with their recoveries can neither augment nor diminish their rights against the estate, which turn instead solely upon the debts owed to them individually by the bankrupt.

In sum, the teaching of the *Nathanson* case is that the United States may not invoke its priority right so as to gain priority for a claim actually owned by a private person. That teaching is inapplicable here because the S.B.A.'s assertion of priority is solely for a claim entirely its own, a claim which arose from a loan made by the S.B.A. to the bankrupt. What the S.B.A. has contracted to do with its recovery from the bankruptcy proceeding is irrelevant to the determination of rights in that proceeding, just as are the out-

side contractual obligations of the other bankruptcy creditors. Nor can allowance of the priority claim here in any way interfere with the policy of equitable distribution of the Bankruptcy Act, since the other bankruptcy creditors would be entitled to recover no more if the S.B.A. had no contractual arrangement with the Bank. We submit, therefore, that there is nothing in the participation agreement justifying an exception to "the operation of so clear a command as that of § 3466." *United States v. Emory*, 314 U.S. 423, 433.

B. THE POLICIES UNDERLYING THE SMALL BUSINESS ACT REQUIRE  
THAT THE S.B.A.'S CLAIM BE ACCORDED PRIORITY

As already noted, it is our basic position that the S.B.A. is entitled to priority on its share of the loan under the settled principles traditionally applied by this Court in interpreting R.S. § 3466. In addition, however, we believe there are important policy considerations which reenforce the conclusion that the S.B.A. is entitled to priority here. Indeed, if the purposes of the Small Business Act are to be achieved fully, it is essential that the S.B.A. have a right of priority to aid it in recovering the funds disbursed by it in participation loans.

In enacting the Small Business Act of 1953, Congress expressly noted that the security and economic well-being of the Nation depended on the development and encouragement of small business enterprises. Sec. 202, 67 Stat. 232; 15 U.S.C. 631.<sup>7</sup> To that end,

<sup>7</sup> After several amendments, the Act was reenacted in 1958. 72 Stat. 384, 15 U.S.C. 631-651. All the sections of the 1953 Act cited in this brief have been reenacted in virtually iden-

Congress created the Small Business Administration and authorized it to make loans, with funds derived from Congressional appropriations, to small business concerns, "either directly or in cooperation with banks or other lending institutions through agreements to participate on an immediate or deferred basis." Sec. 207(a), 67 Stat. 236; 15 U.S.C. 636(a). It was further provided, however, that (Sec. 207(a) (1), 67 Stat. 236; 15 U.S.C. 636(a)(2)):

\* \* \* no immediate participation may be purchased unless it is shown that a deferred participation is not available; and no loan may be made unless it is shown that a participation is not available \* \* \*.

Since the statutory scheme thus contemplates that private loan aid is to be enlisted by the S.B.A. to whatever extent it is available, loans made by the S.B.A. in participation with private institutions have constituted the bulk of the S.B.A.'s business loan program, and will continue to do so.\* The success of such a participation program depends entirely, of course, on the willingness of private lending institutions to join in the program offered by the Government agency and to assume thereby a portion of the attendant risks.\* The possibility of being indemnified, at least in part, by the United States,

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tical form in the 1958 Act, and all U.S. Code references are for convenience given to the 1958 edition of the Code.

\* See statistics in Petition for a Writ of Certiorari, pp. 14-15.

\* These risks are, of course, not insubstantial. In view of statutory prerequisites as to their availability, S.B.A. loans are often extended to concerns whose insolvency is not unlikely.

which is more likely to collect its debts because of its right of priority, has provided a vital incentive for banks to take these risks and participate in the S.B.A.'s program. Recognition of the S.B.A.'s right to claim a debt priority (but, of course, solely with respect to that portion of the loan actually disbursed by it) and to then remit, pursuant to contract, a share of that priority recovery to the participating bank, is, we believe, essential to safeguard this incentive feature of the Congressionally devised participation program and, by the same token, vital to the program's success.

In contrast, the view adopted by the court below would seriously impair the S.B.A. program by rendering it far less attractive to prospective bank participants. Under that decision, the S.B.A. would be required, in order to avoid forfeiting its right of priority for moneys advanced by it, to revise its participation agreements to limit the sharing provisions to non-priority proceeds. There are, we think, few lenders who would be willing to participate on such terms—namely, being full partners in advancing the money but not in sharing the proceeds.<sup>10</sup> That, we submit, is a strong reason for allowing the priority here, for the “established rule of liberal construction requires that the priority act be applied having regard to the public good it

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<sup>10</sup> See also *Petition for a Writ of Certiorari*, p. 16; 108 U. Pa. L. Rev. 909, 914 (1960).

As we pointed out in our petition for certiorari, the contractual provision relating to the pro rata sharing of gains and losses is also in common use in various other Government participation loan programs.

was intended to advance." *Bramwell v. U.S. Fidelity Co.*, 269 U.S. 483, 492.

Another important factor is that the decision below, by denying the S.B.A. a right of priority on all sums advanced by it under its present participation program, may well have the effect of making a small business's creditors eager to force the business into bankruptcy immediately after it receives an S.B.A. loan in order to reap a benefit from the loan funds. To that extent, instead of aiding and encouraging the continued operation of a small business, the S.B.A. loan would hasten its demise.<sup>11</sup> On the other hand; if the S.B.A. were allowed priority on its advances, creditors would have nothing to gain from an immediate bankruptcy, and the loan's purpose—to stimulate confidence in the business and to enable it to continue functioning—would more likely be served. Similarly, under the Tenth Circuit's view, creditors will be tempted to induce small businesses to obtain S.B.A. participation loans merely for the creditors' benefit in the event of bankruptcy. Such a purpose in securing a loan would not fulfill any of the objectives of the Act and, indeed, is contrary to the S.B.A.'s regulations. 13 C.F.R. 120.4-2(d)(1)(i).<sup>12</sup>

<sup>11</sup> These consequences of a holding that the S.B.A. cannot claim priority on its participation loans would be harmful to the S.B.A.'s program under any circumstances. However, in times of economic depression they would be particularly grave. S.B.A. loans would be the only source of credit available to many small businesses, but the making of an S.B.A. loan would serve primarily as an incentive to the business's private creditors to recover what funds they could by an immediate bankruptcy proceeding.

<sup>12</sup> Furthermore, in many situations it will be obviously unjust

C. IF ALLOWING THE BANK TO SHARE THE PROCEEDS OF THE PRIORITY WOULD BE INCONSISTENT WITH THE PURPOSES OF R.S. § 3466, THE APPROPRIATE REMEDY, WOULD BE FOR AN APPROPRIATE COURT TO DENY THE BANK'S PARTICIPATION RATHER THAN TO DISALLOW THE S.B.A.'S PRIORITY IN ITS ENTIRETY

We have thus far sought to show that what the S.B.A. proposes, or has obligated itself, to do with the proceeds of its priority are of no concern in determining its rights to the priority. We will now show, however, that even accepting the court of appeals' view that no priority can be allowed which would result in a benefit to the Bank, it would not follow that the proper remedy is to disallow the priority in its entirety. Rather, we submit, the proper remedy in that case would be for an appropriate court to deny enforcement of the Bank's right to share in the proceeds attributable to the priority.

The court of appeals, having concluded that it would be inconsistent with the purposes of R.S. § 3466 to allow a priority which would benefit the Bank, apparently believed that it was faced with a dilemma. If it allowed the priority, the Bank would be benefited, thereby violating the assumed limitation on R.S. § 3466. If it denied the priority, the United States

to deny the S.B.A. priority on its debt claim in bankruptcy because the proceeds of the S.B.A.'s loan funds will comprise the bulk of the bankruptcy estate. S.B.A. participation loans, by necessity, go to small businesses that cannot get credit from other sources. When such a business goes into bankruptcy, its remaining funds will often be traceable to the S.B.A. loan. Thus, it may not be a coincidence that, in the case at bar, a \$20,000 participation loan was extended, and \$19,000 is the amount in the trustee's hands—particularly since the involuntary petition in bankruptcy was filed less than a year after the loan was made.

would not be assured payment of the debt admittedly due it, thereby frustrating the primary purpose of R.S. § 3466. Faced with that choice, the court presumably concluded that the policy of precluding a private benefit was more compelling than that of assuring the public benefit, and so held that the S.B.A.'s right to prior payment must be sacrificed to prevent any benefit accruing to the Bank.

Even accepting the court's view on the merits, it was not, we think, forced to that choice, for there was another remedy that would avoid both the assumed evil of allowing the Bank to participate and the frustration of R.S. § 3466 by denying the S.B.A. its priority—namely, granting the S.B.A. priority on its claim but recognizing that enforcement of the sharing agreement to the extent that it purports to apply to priority proceeds would be subject to attack in an appropriate proceeding. The result of the court of appeals' view is that the agreement to share priority proceeds is itself invalid, or at least impossible of performance, and if that is so it is difficult to see why denying enforcement of that agreement would not be a fully appropriate remedy. That remedy would be no more burdensome to the Bank than disallowing the priority entirely,<sup>13</sup> would avoid the collateral con-

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<sup>13</sup> One slight adjustment might be required to avoid prejudicing the Bank—namely, requiring the United States to pay over to the Bank out of its recovery the amount by which the Bank's participation in the estate as a common creditor would have been augmented by a disallowance of the S.B.A.'s priority. Even assuming that the Bank is not entitled to the *benefit* of the S.B.A.'s priority, it would seem at least to be entitled by its agreement not to be *injured* by it—i.e., not to have its participation in the estate diminished by the S.B.A.'s assertion of priority. With that adjustment, however, not even the

sequence of depriving the United States of the priority which it was the very purpose of R.S. § 3466 to give it; and would cause no disadvantage to the other creditors beyond that dictated by R.S. § 3466 itself.

The court of appeals' decision, on the other hand, produces drastic consequences wholly unrelated to the evil sought to be remedied. In authorizing participation agreements of the kind here involved, the Administrator clearly did not intend to waive the United States' right to priority (if, indeed, he was authorized to do so), and the effect of the decision below is to impose a forfeiture of the Government's priority rights on all the loans outstanding under such agreements merely because of a mistake of law by the Administrator in considering such agreements to be proper. In this case, for example, because the Administrator improperly (in the court's view) agreed to pay \$3,000 of the priority proceeds over to the Bank, the United States is to be denied substantially all of its recovery on a \$12,000 debt—a recovery that it was the very purpose of R.S. § 3466 to assure. Such a result might be justified if the other creditors had in some way been prejudiced by the sharing

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Bank could object to limiting the remedy to rejection of its participation rather than disallowing the S.B.A.'s priority in its entirety, for the result to it would be the same.

The effect of that adjustment, it may be noted, would be not to allow the Bank to participate in the priority but only to deny to the S.B.A. any priority *vis-à-vis* the Bank. That limitation on the S.B.A.'s priority is justified by the Bank's reliance upon its agreement of equal treatment in lending the money, and the other creditors would not be prejudiced since the adjustment would come out of the S.B.A.'s recovery.

agreement, but as we have shown above they have in no way been affected by the agreement and will receive the same distribution they would have received had the agreement not been made. Thus the result of the decision below is simply to give to the other creditors, at the expense of the United States, a windfall over what they could otherwise have expected to receive.

If, as R.S. § 3466 establishes, the public interest requires that debts due the United States be first satisfied, there can, we submit, be no justification for forfeiting that protection of the public interest in its entirety merely because a public official erroneously—though in good faith and without prejudice to other creditors—agreed to share a part of the proceeds of that priority with a private party. Particularly is that so where, as here, the result of so subordinating the public interest is not to compensate persons injured by the alleged error but simply to produce a windfall for persons in no way affected by it. We submit, accordingly, that if allowing the Bank to participate in the proceeds of the S.B.A.'s priority would offend the policy of R.S. § 3466 (which we deny), the appropriate remedy would be simply to test out the Bank's right to that participation in an appropriate case. There is no need at the same time to frustrate the primary purpose of that very statute by denying the United States priority on the debt due it.

We are of course aware that if that be the proper remedy, the objection of the trustee and the other creditors to the Bank's contractual participation in the proceeds of the S.B.A.'s claim, even if upheld,

would avail them nothing. That, however, goes only to emphasize our primary point that the agreement between the S.B.A. and the Bank to pool their proceeds and losses on the loan transaction does not affect the rights of, and is of no concern to, the other creditors and ought to be irrelevant to this proceeding.

## II

### A 75% INTEREST IN THE DEBT WAS OWNED BY THE S.B.A. BEFORE BANKRUPTCY

Although the court of appeals did not reach the question, the district court held that no debt was due the S.B.A. from the bankrupt until the Bank transferred the note to the S.B.A. after the bankruptcy petition had been filed, and hence that the S.B.A. was not entitled to priority (R. 42-43). We do not question that the rights are to be determined as of the date on which the petition in bankruptcy was filed (*United States v. Marxen*, 307 U.S. 200), but in our view it is clear that the S.B.A. acquired full ownership of 75% of the debt upon the initial purchase of its participation and that the possession of the note was immaterial.

1. The participation agreement entered into by the S.B.A. and the Bank before the loan was made provided that (par. 2, R. 4):

SBA, upon written demand by Bank, will purchase from Bank a participation of 75 per cent of each disbursement made by Bank to Borrower on account of the Loan, immediately after such disbursement, for an amount of money equal to the amount of said participa-

tion. Immediately upon each such purchase, Bank will execute and deliver to SBA a Participation Certificate on SBA Form 152 evidencing the interest in the Loan so purchased.

It was further provided that any security held by the Bank or the S.B.A. "shall secure the interests of both Bank and SBA in the Loan" (par. 6, R. 5); that neither party would "assign \* \* \* its interest in the Loan" without the consent of the other (par. 7, R. 6); that the Bank would hold the note but upon written demand from the S.B.A. would "transfer" the note within five days to the S.B.A., receiving back a "Certificate of Interest" evidencing the Bank's retained interest (par. 11, R. 8); that the holder of the note "shall receive all payments on account of principal of, or interest on, the Loan and promptly remit to the other party its pro rata share thereof determined according to their respective interests in the Loan" (par. 12, R. 8); and that neither party made any "warranty" of the loan or assumed any liability to the other "for any loss, not due to its own gross negligence, but such loss, shall be borne ratably by SBA and Bank in accordance with their respective interests in the Loan" (par. 14, R. 9).

Pursuant to that agreement, the Bank promptly made demand on the S.B.A. to purchase a 75% participation in the \$20,000 loan, the S.B.A. paid the Bank \$15,000, and the Bank executed and delivered to the S.B.A. the required participation certificate reciting that the S.B.A. "has purchased from Bank a par-

participation of 75% of" the loan pursuant to the participation agreement (see Statement, *supra*, p. 6).<sup>14</sup>

From the terms of the participation agreement governing the purchase and its consequences, it is evident that what the S.B.A. "purchased" for its \$15,000 was neither more nor less than an undivided ownership interest in 75% of the debt, the S.B.A. and the Bank thereby becoming tenants-in-common of the debt. All rights and liabilities of the parties thereafter were to be determined strictly "in accordance with their respective interests in the Loan" and any independent warranties or other liabilities from one to the other were expressly disavowed. The only rights that either party thereafter possessed were the rights arising out of its ownership of an interest in the loan—namely, to have the other party account to it, in accordance with its interest, for any proceeds of the loan. The participation agreement, indeed, seems to have done no more than to make express the usual

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<sup>14</sup> While it seems to us unimportant, it may also be noted that the bankrupt was fully aware of the S.B.A.'s proposed participation in the loan from the outset. The loan application itself was made on an S.B.A. form and was, indeed, directed primarily to the S.B.A. (R. 15-24). So also, although it seems to us irrelevant whether the S.B.A.'s participation was purchased before or after disbursement of the loan, it may be noted that the participation agreement contemplated the S.B.A.'s immediate purchase of a 75% participation and that the loan was in fact not disbursed until after demand had been made on the S.B.A. and the S.B.A. had forwarded its check (though the check was not to be negotiated until the loan was actually disbursed) (see Statement, *supra*, pp. 3-6).

incidents of ownership that would arise upon the assignment by one party of an undivided interest in a debt to another. And, since the Bank undertook no independent obligations to the S.B.A., it is difficult to see what the S.B.A. did acquire if it was not an ownership interest in the debt.

We are unable to understand, then, how it can be said that the S.B.A. was not, after its purchase, the "owner" of 75% of the debt.<sup>15</sup> It is true that the parties agreed that the Bank should hold the note and collect the payments unless and until the S.B.A. requested transfer of the note to it. That, however, was not at all inconsistent with joint ownership, and the effect was simply to make the Bank the collection agent for the tenants-in-common until the S.B.A. should direct otherwise. Obviously the ownership rights obtained by an assignee of a claim are unaffected by his designation (here, in fact, a revocable designation) of the assignor as the collecting agent. See, e.g., *Hawley Down-Draft Furnace Co.*, 238 Fed. 122 (C.A. 3); *Cogan v. Conover Mfg. Co.*, 69 N.J. Eq. 809, 64 Atl. 973; 4 Corbin, *Contracts*, p. 522. Cf. *Rohr Aircraft Corp. v. County of San Diego*, 362 U.S. 628.

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<sup>15</sup> See *In re Westover, Inc.*, 82 F. 2d 177 (C.A. 2); *In re Prudence Bonds Corp.* 79 F. 2d 212 (C.A. 2); *Delatour v. Prudence Realization Corp.*, 167 F. 2d 621 (C.A. 2); *In re Prudence Co.*, 89 F. 2d 689 (C.A. 2), holding that the holders of participation certificates issued by a mortgagee evidencing participating interests in the mortgage and bond are creditors of the mortgagor, not of the mortgagee, so that their rights are not affected by the bankruptcy of the mortgagee.

See also 108 Pa. L. Rev. 909, 913 (1960), commenting on this case.

Moreover, since, upon requesting transfer of the note to it, the S.B.A. was required to give the Bank a "Certificate of Interest" evidencing its retained interest in the debt and thereafter account to the Bank in the same way the Bank had accounted to it, it is clear that the transfer of the note itself had no effect upon the respective interests in the debt and amounted to no more than a mere transfer of possession and of the duty to act as the servicing agent. Clearly, therefore, the assignment to the S.B.A. of a 75% interest in the debt occurred, if it occurred at all, when it purchased that interest, evidenced by the participation certificate, and not when, after bankruptcy, the note was formally transferred to it. The note was simply the evidence of the whole debt which the Bank and the S.B.A. owned in common and was to be held by one party or the other as suited their convenience, the possession of the note having no effect on their underlying interests.

Whether or not the S.B.A. could have maintained a suit on the debt in its own name without first obtaining possession of the note—apparently thought crucial by the district court (R. 42)—seems to us irrelevant. The right to priority under R.S. § 3466 turns, not on the agency through whom collections are made, but solely on the beneficial ownership of the debt—a proposition which respondent would have been the first to endorse had the note been transferred to the S.B.A. before bankruptcy and the S.B.A. were here claiming priority for the Bank's interest in the debt as well as its own. See *Nathanson v. NLRB*, 344 U.S. 25; *United States v. Remund*, 330 U.S. 539,

542.<sup>16</sup> In any event, since the S.B.A. had the right at any time to require the Bank to transfer the note to it on five days' notice, there was in fact no possible obstacle to the S.B.A.'s enforcing the debt at any time it chose.

2. The district court's decision is in no way supported by *United States v. Marzen*, 307 U.S. 200, upon which it relies. In that case, the Federal Housing Administration had insured a loan on which the borrower defaulted prior to bankruptcy, thereby precipitating the F.H.A.'s obligation to make payment of its guaranty. The guaranty was not in fact paid, however, until after bankruptcy. This Court held that the F.H.A. had not become subrogated to the bank's claim against the bankrupt until actual payment of the guaranty, and hence that there was no existing debt due the F.H.A. from the bankrupt at the date of bankruptcy. That decision, it seems to us, is of no help to respondent here since the S.B.A. had in fact made payment and received an ownership interest in the debt long before bankruptcy.

More in point is the decision of the Tenth Circuit in *Reconstruction Finance Corp. v. Riverview State*

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<sup>16</sup> See also *Price v. United States*, 269 U.S. 492, 500 ("[The purpose of R.S. § 3466] is not to be defeated by unnecessarily restricting the application of the word 'debts' within a narrow or technical meaning."); *Lewis v. United States*, 92 U.S. 618, 621 ("A valid indebtedness is as effectual in one form as another. No discrimination is made by the statute."); *Beaston v. Farmers' Bank*, 12 Pet. 102, 134 ("All debtors to the United States, whatever their character, and by whatever mode bound, may be fairly included within the [statutory] language").

*Bank*, 217 F. 2d 455, which involved an immediate participation agreement entered into by the R.F.C. almost identical to that involved here. The court held there that the ownership interest of the R.F.C. came into existence, for bankruptcy purposes, when the R.F.C. became legally committed to buy an immediate participation in the loan, even though actual payment was not made until after bankruptcy. This case is, of course, *a fortiori* to that, since both actual payment and delivery of the participation certificate took place before bankruptcy.

### III

DEBTS DUE THE S.B.A. ARE "DEBTS DUE TO THE UNITED STATES" WITHIN THE MEANING OF R.S. § 3466

Although the referee held that the S.B.A. was not the "United States" within the meaning of R.S. § 3466 (R. 35), that argument (though not reached by the court of appeals) was fully answered by the district court (R. 40-42) and need be only briefly considered here.

It is now firmly established that a non-incorporated agency of the United States must be regarded as the United States for the purposes of R.S. § 3466. See *United States v. Remond*, 330 U.S. 539; *United States v. Emory*, 314 U.S. 423; and *Korman v. Federal Housing Administrator*, 113 F. 2d 743 (C.A.D.C.), holding that the Farm Credit Administration and the Federal Housing Administration were entitled to the priorities of the United States. Cf. *United States*

v. *McNinch*, 356 U.S. 595, 598. Structurally, the S.B.A., like those agencies, is a non-incorporated federal agency created by Congress. 67 Stat. 233, as amended, 15 U.S.C. 633. The Administrator is appointed by the President with the advice and consent of the Senate, and the powers of the agency are vested in him. 15 U.S.C. 633(b). The agency is charged with the administration and execution of various small business programs, and the monies upon which those operations are based have their origin in Congressional appropriations. 15 U.S.C. 633(c). The S.B.A., in short, is as much an agency of the United States as any other non-incorporated executive agency.

That status is not altered by the fact that the Administrator in carrying out his statutory duties is authorized in his official capacity to "sue and be sued in any court of record of a State having general jurisdiction, or in any United States district court, \* \* \*." 15 U.S.C. 634(b)(1). Corporate status, whatever difference that might make, was not conferred thereby. The sole effect of the "sue and be sued" provision was to preclude the assertion of sovereign immunity in suits against the agency, and, as a matter of convenience, to permit the Administrator to appear in his official capacity to press the claims of the agency. Cf. *Korman v. Federal Housing Administrator*, 113 F. 2d 743 (C.A. D.C.); *In re Wilson*, 23 F. Supp. 236, 240 (N.D. Tex.).

## IV

THE SMALL BUSINESS ACT NEITHER EXPRESSLY NOR IMPLIEDLY EXCEPTS LOANS MADE UNDER IT FROM THE PRIORITY GRANTED BY R.S. § 3466

There remains for consideration a final contention pressed by respondent throughout these proceedings, but which none of the tribunals below has adopted and the district court expressly rejected (R. 42)—namely, that even if R.S. § 3466 would in terms grant priority to the debt, the Small Business Act should be construed as excepting loans made under it from that priority.

The conclusion of the district court that there is nothing in the Small Business Act to indicate that Congress intended the S.B.A. to be treated differently from other administrative agencies which have been accorded priority is fully supported. This Court has repeatedly emphasized, in answer to similar arguments, that "Only the plainest inconsistency would warrant our finding an implied exception to the operation of so clear a command as that of § 3466." *United States v. Emory*, 314 U.S. 423, 433; *United States v. Remond*, 330 U.S. 539, 544-545; *Illinois v. United States*, 328 U.S. 8, 12; *Massachusetts v. United States*, 333 U.S. 611, 634. Accordingly, only in the presence of express language (*Mellon v. Michigan Trust Co.*, 271 U.S. 236) or of a basic inconsistency with the avowed purpose of a particular statute (*Cook County National Bank v. United States*, 107 U.S. 445; *United States v. Guaranty Trust Co.*, 280 U.S. 478) has this Court found a legislative intent to waive the priority

conferred on the United States and its agencies by R.S. § 3466.

There is of course nothing in the Small Business Act expressly denying priority to loans made under it, and respondent's argument must rest solely on its assertion that affording priority on such loans would be inconsistent with a claimed objective of the Small Business Act to enhance the general credit standing of small businesses, which credit would be impaired by the anticipation that, in the event of insolvency, the S.B.A.'s claim would be given priority. An identical argument was made to this Court in *United States v. Emory*, 314 U.S. 423, as a reason for not granting priority to a loan made pursuant to the National Housing Act. The Court found no evidence of a specific purpose to build up the general credit standing of the borrowers (p. 433), as distinguished from the simple and direct purpose of providing the funds needed for construction and thereby "to stimulate the building trades and to increase employment" (p. 430), and concluded (p. 431):

Consequently, the argument against the application of § 3466 is reduced to this: Private persons in general are reluctant to extend credit when they know that in the event of the borrower's insolvency the claims of the United States will receive priority, and this circumstance is particularly undesirable in times of economic stress. In the first place, whatever may be the merits of the contention, it should be addressed to Congress and not to this Court. In the second place, the argument proves too much. If it is sound as applied to this kind of

a claim of the United States; it is equally sound as applied to all claims as to which the United States asserts priority under § 3466.

The argument was again rejected in *United States v. Remund*, 330 U.S. 539, involving emergency feed and crop loans made by the Farm Credit Administration. Although the loans were in fact given to farmers whose credit was impaired, their purpose, the Court observed (p. 543), was not to restore the farmers' credit status as such but simply to provide them with the money needed "to purchase feed and to plant crops" and which they were unable to obtain from other sources. Since giving priority to the loans "could in no way impair the aid which the farmers sought through these loans" (p. 544), the Court found no such basic inconsistency of purpose as would be necessary to find an implied exception to R.S. § 3466.

Like the Federal Housing Act and the farm credit statutes, the Small Business Act is primarily concerned, not with building up the credit status of particular businesses as such (i.e., to make them attractive as investments to other lenders), but simply to supply the funds immediately needed by them for the conduct of their business and which are not available from other sources—a purpose necessarily implicit in the requirement that private sources of loans be utilized to the extent they are available. That is, it was the immediate financial needs of small businesses, not the protection of their creditors, with which Congress was concerned. And just as in *Emory* the ultimate purpose was to bolster the national economy, so the preamble of the Small Business Act (15 U.S.C.

631(a)) makes clear that that was the ultimate purpose of granting economic aid to small businesses. In short, we submit, giving priority to such loans in the event of bankruptcy in no way impairs the value of the loan to a small business needing funds for its immediate operations (here, as working capital) which it cannot otherwise obtain, and thus in no way frustrates the purpose of the Small Business Act.

The essence of this Court's repeated view that exceptions to R.S. § 3466 are to be inferred only on a showing of irreconcilable conflict between that statute and another is that the judgment whether other purposes will be so seriously impaired as to justify a waiver of priority is one for Congress to make rather than the courts. Congress, in turn, has been fully aware of its responsibility and on occasion, when the matter has been presented to it and it has found the claims justified, has expressly waived the right of priority. It did so, for example, by an amendment to the Reconstruction Finance Corporation Act when, after loans under it had been held entitled to priority, it was found that giving priority to such loans was unduly prejudicial to other creditors. Act of May 25, 1948, 62 Stat. 261; see *In re Temple*, 174 F. 2d 145 (C.A. 7). That express waiver of priority for loans made by the R.F.C. is particularly significant here, since the very Act that created the S.B.A. also provided for the liquidation of the R.F.C. Act of July 30, 1953, 67 Stat. 230. Had Congress, having expressly and only recently denied priority to the R.F.C., intended similarly to deny priority to the S.B.A., it presumably would have said so.

Finally, any doubt that Congress did not intend to deny priority to loans under the Small Business Act is, we submit, removed by the legislative history of the 1958 amendments to that Act. Act of July 18, 1958, 72 Stat. 384. One of the proposed amendments considered in the Senate hearings was a proposal by Senator Payne that no debt due the S.B.A. should be entitled to the priority available to the United States under R.S. § 3466. See S. 3319, 85th Cong., 2d Sess. When introducing that bill, Senator Payne indicated that its purpose was to prevent claims of S.B.A. from taking precedence over state and local tax debts. 104 Cong. Rec. 2470. While the S.B.A. agreed that it should not be entitled to such priority over state and local tax liens, it opposed S. 3319 because it believed that the bill would prevent the S.B.A. from claiming priority even over non-governmental claims, as here. See *Hearing before the Subcommittee on Small Business of the Senate Committee on Banking and Currency with respect to the Credit Needs of Small Business*, 85th Cong., 2d Sess., pt. 2, p. 553. In deference to the views of the S.B.A., an amendment was adopted which provided only that any interest the S.B.A. held as security for a loan was to be subordinated to state and local tax liens to the same extent that it would be under state law if a private party held that interest. 72 Stat. 396, 15 U.S.C. 646. Significantly, the broad proposal to deny all priority to the S.B.A. was not adopted. Those actions demonstrate conclusively Congressional acceptance of the administrative view that the S.B.A. was entitled to

R.S. § 3466 priority under the Small Business Act as passed in 1953. See S. Rep. No. 1714, 85th Cong., 2d Sess., p. 10.<sup>17</sup>

#### CONCLUSION

For the foregoing reasons, we respectfully submit that the judgment of the court of appeals should be reversed.

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<sup>17</sup> See also 108 U. Pa. L. Rev. 909, 912 (1960).